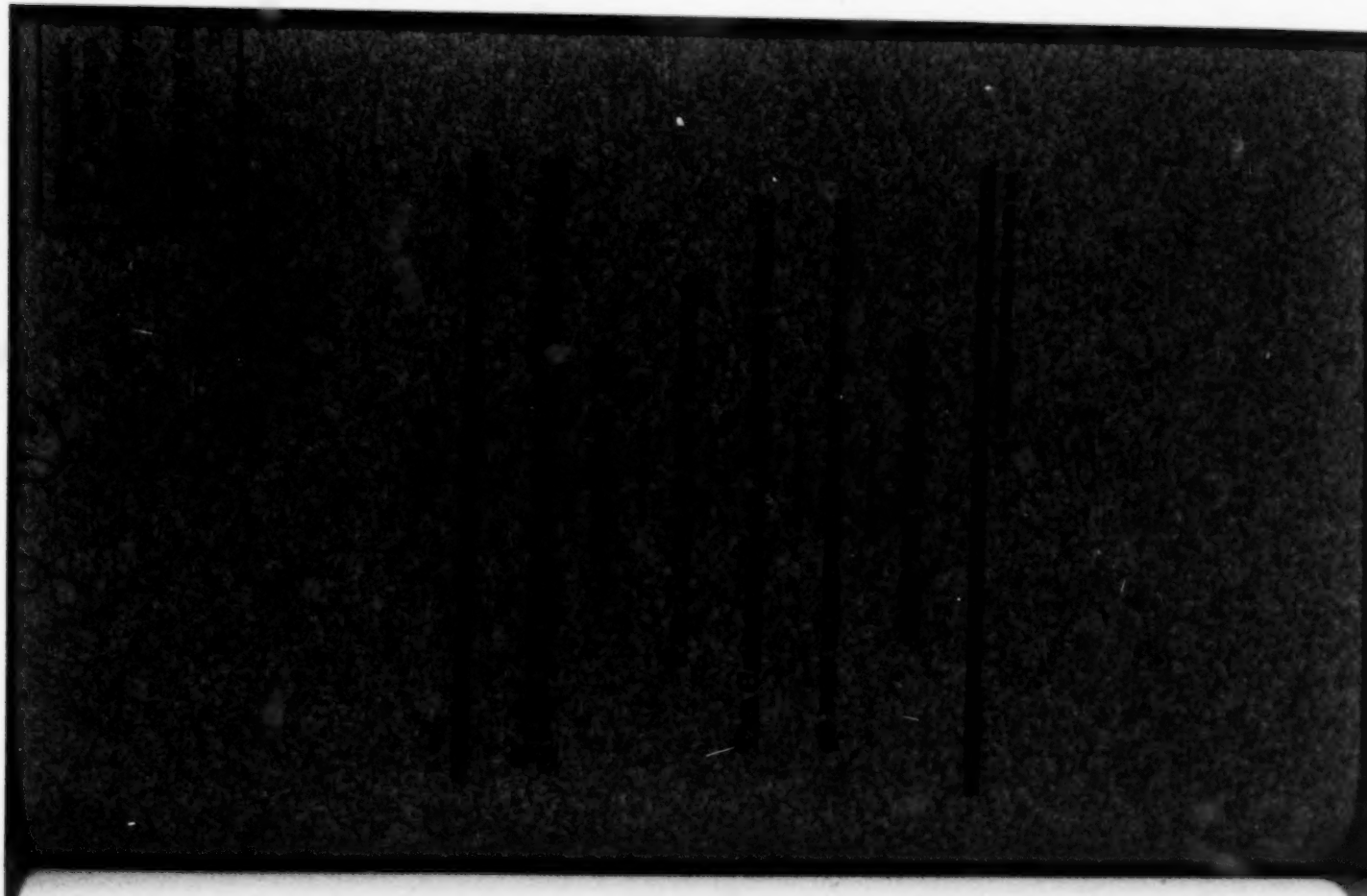

INDEX

	Page
Opinion	1
Jurisdiction	1
The question	1
Statutes involved	2
Statement	2
Summary of argument	3
Argument	7
Conclusion	8
Appendix	21
	22

CITATIONS

Cases:	
Acklin v. *People's Savings Assn.*, 293 Fed. 392	20
Broadview Savings & Loan Co. v. *Commissioner*, 10 B. T. A. 725	14
Burk-Waggoner Oil Assn. v. *Hopkins*, 269 U. S. 110	13
Central Bldg., Loan & Savings Co. v. *Bowland*, 216 Fed. 526	13
Eversmann v. *Schmidt*, 53 Ohio St. 174	9, 17
Gray v. *Baltimore Bldg. & Loan Assn.*, 48 W. Va. 164	18
Johnstown Bldg. & Loan Assn., Appeal of, 6 B. T. A. 463	14
Leahy v. *National Bldg. & Loan Assn.*, 100 Wis. 555	17
Lilley Bldg. & Loan Co. v. *Miller*, 285 Fed. 1020; certiorari denied, 262 U. S. 754	12
Pacific Bldg. & Loan Assn. v. *Hartson*, 201 Fed. 1011	13
Parkview Bldg. & Loan Assn. v. *Herold*, 203 Fed. 876	13
People v. *Preston*, 140 N. Y. 549	18
Rhodes v. *Missouri Savings & Loan Co.*, 173 Ill. 621	17
Statutes, etc.:	
Act of August 27, 1894, c. 349, Sec. 32, 28 Stat. 509, 556	11
Act of June 13, 1898, c. 448, Sec. 17, 30 Stat. 448, 455	11
Act of August 5, 1909, c. 6, Sec. 38, 36 Stat. 11, 113, 118	11
Act of October 3, 1913, c. 16, Sec. G (a), 38 Stat. 114, 172	11
Revenue Act of 1916, c. 463, Sec. 11 (a), 39 Stat. 756, 766	11
Revenue Act of 1918, c. 18, Sec. 231, 40 Stat. 1057, 1076	2, 11
Revenue Act of 1921, c. 136, 42 Stat. 227, 253—	
Sec. 213 (b) (10)	29
Sec. 231	3, 11
Treasury Regulations—	
No. 33 (Revised)—	
Art. 68	23
Art. 70	24
No. 33, Art. 87	22
No. 45 (1920 ed.), Art. 515	25
No. 62—	
Art. 89	29
Art. 515	28

Statutes, etc.—Continued.	Page
T. D. 3179, amending Art. 515, Reg. 45	13, 26
Cumulative Bulletins—	
III–1, p. 252, S. M. 1469	20
III–2, p. 218, S. M. 2133	20
III–2, p. 209, S. M. 2116	20
Endlich Law of Building Associations, Secs. 1, 7	9
Sundheim Law of Building & Loan Associations (2d ed.), Secs. 3, 7, 17	9
9 Corp. Juris 920, 921	9
4 R. C. L. 343	9

In the Supreme Court of the United States

OCTOBER TERM, 1928

No. 46

THE UNITED STATES, PETITIONER

v.

THE CAMBRIDGE LOAN AND BUILDING COMPANY

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR UNITED STATES

OPINION

The opinion of the Court of Claims (R. 11–18) is reported in 63 C. Cls. 631.

JURISDICTION

The judgment was entered on June 6, 1927. (R. 18.) A motion for a new trial filed by the United States on August 5, 1927, was overruled on October 17, 1927. (R. 19.) The petition for certiorari filed by the Government on January 16, 1928 (R. 19), was granted April 9, 1928 (R. 19), under the provisions of the Act of February 13, 1925.

THE QUESTION

Is a corporation organized under the laws of the State of Ohio providing for the organization of building and loan associations and savings banks entitled to exemption from Federal taxation under the provisions of Section 231 (4) of the Revenue Acts of 1918 and 1921, respectively, where the funds which it lends are secured in a large part by accepting deposits from persons who are not members of the association and whose loans are made in a large part to persons who are not subscribers to the stock of the association?

STATUTES INVOLVED

The pertinent provision of the Revenue Act of 1918, relative to the exemption of domestic building and loan associations from income taxes and applicable to the calendar years 1918, 1919, and 1920, is to be found in Section 231 (c. 18, 40 Stat. 1057, 1076), reading as follows:

> *Conditional and other exemptions*
>
> SEC. 231. That the following organizations shall be exempt from taxation under this title (Part III—Corporations):
>
> * * * * *
>
> (4) Domestic building and loan associations and cooperative banks without capital stock organized and operated for mutual purposes and without profit.

The pertinent provision of the Revenue Act of 1921, relative to the exemption of domestic building and loan associations from income taxes and

applicable to the calendar years 1921, 1922, and 1923, is to be found in Section 231 (c. 136, 42 Stat. 227, 253), reading as follows:

> *Conditional and other exemptions of corporations*
>
> SEC. 231. That the following organizations shall be exempt from taxation under this title (Part III—Corporations):
>
> * * * * *
>
> (4) Domestic building and loan associations substantially all the business of which is confined to making loans to members; and cooperative banks without capital stock organized and operated for mutual purposes and without profit.

STATEMENT

This is a suit to recover Federal income tax paid by the respondent for the years 1918 to 1923, both inclusive. The years 1918, 1919, and 1920 are controlled by the Revenue Act of 1918, and the years 1921, 1922, and 1923, by the Revenue Act of 1921. The pertinent portions of both Acts are above set forth.

The Government contends that under both Acts a building and loan association, to be entitled to exemption, must conduct its business as a building and loan association in fact, and not merely be designated as such under the laws of the State of its origin. The Government further contends that a building and loan association accepting large sums of money from nonmember depositors, regardless

of the borrowing needs of its members, for the purpose of lending the same to nonmembers, is in fact conducting a banking business and is not entitled to exemption as a building and loan association. The Government further contends that under the Act of 1921 substantially all of the business of a building and loan association must be confined to making loans to members and that in this case the respondent, during the years 1921, 1922, and 1923, to which the Revenue Act of 1921 applies, did a very large and substantial part of its business with nonmembers. The Court of Claims in substance and in effect held that under both Acts a building and loan association organized as such under the laws of the State of its origin is entitled to exemption under the Revenue Act merely because defined as a building and loan association by State law. A judgment was rendered against the Government in the sum of $17,174.67, which included taxes paid for all of said years involved and interest thereon.

The findings by the Court of Claims show that respondent was an Ohio corporation, organized under the laws of that State authorizing the creation of building and loan associations (R. 8); that it made its reports to and was inspected by the Superintendent of Building and Loan Associations of the State of Ohio, and invested its funds in the manner prescribed and permitted under the laws of said State, reporting its investments annually to the State authorities. (R. 8.)

During the time here involved the net profits of respondent (except such as were set aside as a reserve under the State laws and retained as undivided profits) were distributed as dividends to members. (R. 8.) The money raised by respondent during the years involved was principally from payments on stock, from deposits by nonmembers, and from interest on money temporarily deposited by it in banks or loaned to other building and loan associations. (R. 9.) Deposits by nonmembers were evidenced by certificates of deposit or by pass books and could be withdrawn upon notice, and respondent paid interest thereon. (R. 9.) These deposits (Item 6 of Liabilities, Finding VII, R. 9) greatly exceeded the receipts from stock subscriptions (Items 1, 2, and 5 of Liabilities, Finding VII, R. 9) and also greatly exceeded the amounts loaned to members (Finding VIII, R. 10).

The statement of liabilities set out in the Findings of Fact shows that during the period in question respondent had on hand large deposits and accrued interest. (Item 6 of Liabilities, Finding VII, R. 9.) The proportion of such deposits and interest to the total liabilities for each of said years is as follows:

	Per cent		Per cent
1918	53.3	1921	60.8
1919	59.3	1922	61
1920	60.2	1923	62.8

Out of its funds, including these special deposits by nonmembers upon which it paid interest, respondent made loans in large sums to various

persons who were not members of the association in any sense. Finding VIII (R. 10) shows the loans made to members and nonmembers during the period involved. If we consider the table from the standpoint of the total number of loans shown for each year we find the proportion thereof made to nonmembers during each year to be as follows:

	Per cent		Per cent
1918	57.3	1921	23.9
1919	35	1922	20
1920	40.1	1923	9.6

If we consider it from the standpoint of the total amount of the loans shown for each year we find the proportion of loans to nonmembers to be as follows:

	Per cent		Per cent
1918	75.3	1921	44.5
1919	38.4	1922	35
1920	55.4	1923	1.7

The Findings also show that during said years respondent made substantial loans to other building and loan associations. (Item 10 of Assets, Finding VII, R. 9.) The proportion of such loans to the assets for each of said years, respectively, is as follows:

	Per cent		Per cent
1918	10.2	1921	3.8
1919	13.1	1922	6.1
1920	7.2	1923	9.9

If we add for these years the deposits in other building and loan associations (Item 10 of Assets, Finding VII, R. 9), the deposits in other financial institutions (Item 11 of Assets, Finding VII, R. 9), and the loans to nonmembers (Finding VIII, R. 10), we find that the percentages of such business, all

of which must have been with nonmembers, to the total loans and deposits of petitioner are as follows for the respective years:

	Per cent		Per cent
1918	85.94	1921	50.47
1919	58.04	1922	50.88
1920	63.68	1923	25.36

During the years involved the loans increased over $806,000. (Items 2, 3, and 4 of Assets, Finding VII, R. 9.) Special deposits increased over $630,000. (Item 6 of Liabilities, Finding VII, R. 9.) Paid-up stock increased over $135,000. (Item 5 of Liabilities, Finding VII, R. 9.) But loan and running stock decreased over $62,900. (Items 1 and 2 of Liabilities, Finding VII, R. 9.)

SUMMARY OF ARGUMENT

The Congress provided that building and loan associations should not be subject to the corporation income tax in order to exempt from income tax those organizations which enable persons whose earnings are small to become, by a system of compulsory savings, the owners of homesteads either at the end of a certain time or in anticipation of it. Although it did not define the term "building and loan association," Congress used this term in its ordinary significance, intending to exempt those organizations which performed a public service, but not those organizations which, though calling themselves building and loan associations, were operated for private gain.

The respondent is not such an organization as the Congress intended to exempt because its business is conducted primarily for the sake of profit and not to enable persons of small means to acquire, out of their savings, homes or other property.

The respondent clearly is not exempt under the Revenue Act of 1921 because substantially all of its business did not consist of making loans to members.

The construction and application by the Bureau of exemptions granted in prior Acts is not such a consistent and established construction as to influence the Court in construing the Acts of 1918 and 1921, and, moreover, the language of these Acts differs from the language of the prior Acts.

ARGUMENT

The term "building and loan association" refers to societies organized for the purpose of raising by subscriptions of the members a fund for making advances to members upon mortgages for the purpose of building or buying homes. The funds of such associations are derived from periodical payments by members, interest and premiums paid by borrowing members; fixed periodical installments paid by borrowing members; fines for failure to pay such fixed installments; forfeitures; fees for transferring stock; entrance fees, and any other revenues or payments, all of which go into the common treasury. When the installment payments and profits equal the face value of the shares issued the shares are said to mature and the face value

thereof is distributed to the stockholders owning same. A member is entitled to borrow on sufficient mortgage security an amount equal to his subscription for shares, and when his shares are paid up they operate to cancel his indebtedness. Although there are many plans for conducting such associations, introducing varying incidental factors, the theory of them all is that members contribute the capital and constitute the borrowers, and that the shares issued are partly paid for by members and partly earned by the operations of the association to the end that both the savings of the members and the earnings of their joint effort may be used by the members for acquiring homes. Such associations distinctly and fundamentally are not money-making enterprises. They are essentially mutual and cooperative. The membership consists of borrowers and lenders, and the profits inure equally to members, both borrowers and lenders.

Sundheim Law of Building and Loan Associations (2nd Ed., 1922) Sections 3, 7, and 17.

Endlich Law of Building Associations, Sections 1, 7.

9 Corpus Juris, 920, 921; 4 R. C. L. 343.

Eversmann v. *Schmitt*, 53 Ohio State, 174.

Such associations serve a unique public purpose. On the one hand, by means of compulsory savings they inculcate habits of thrift. On the other hand, they make it possible for those having small incomes to own homes, and thus to acquire positions in the community supposed at least to improve

their material, social, and political conditions. Their benefit to the community at large is not that the members earn more on their investment or are enabled to borrow at a low rate, because these factors are not usually present. Their benefit to the community is reflected in the elevation of the individual from a dependent to an independent status with the accompanying sense of responsibility, both as an individual and as a member of society, which accompanies home ownership. Habits of thrift and economy are established. The moral tone of the community is elevated. For that reason these organizations have been favored in law. They have been relieved from the operation of the usury laws; the liability of their members to each other and to the public has been limited and fixed by statute; they have been exempted from the operation of tax laws and other benefits have from time to time been conferred upon them.

The Government submits that it was such organizations which, for such reasons, Congress intended to exempt from the operation of the Federal income tax laws. The name "building and loan association" in common usage and in ordinary understanding connotes such associations and not associations created under statutes which enlarge the scope of operation beyond the primary purpose of such organization. In so far as that operation is enlarged, the primary public service is diminished, private interest is increased, and the basic reason for tax

exemption eliminated. Certainly Congress has indicated no intent to relieve commercial enterprises from taxation. Other corporations which are exempt from the operation of the Acts, as will appear from a reading of Section 231 of the Revenue Act of 1918, and the corresponding section (231) of the Revenue Act of 1921 are all organizations of a mutual and cooperative character which serve, or at least are thought to serve, a purpose in which the public is similarly interested.

This conclusion is strengthened by the fact that all the Acts restrict the term "building and loan association" either by the qualification that they must confine their business to making loans to their shareholders (see Section 32, Act of August 27, 1894, c. 349, 28 Stat. 509, 556; Section 17, Act of June 13, 1898, c. 448, 30 Stat. 448, 455; Section 231 (4), Revenue Act of 1921, c. 136, 42 Stat. 227, 253), or else must be organized and operated exclusively for the mutual benefit of their members. (See Section 38, Act of August 5, 1909, c. 6, 36 Stat. 11, 113, 118; Section G (a), Act of October 3, 1913, c. 16, 38 Stat. 114, 172; Section 11 (a), Revenue Act of 1916, c. 463, 39 Stat. 756, 766; Section 231 (4), Revenue Act of 1918, c. 18, 40 Stat. 1057, 1076.) The latter limitation in the Act of 1909 is unquestionable, but in the Acts of 1913, 1916, and 1918 some question has been raised by reason of the fact that organizations other than building and loan associations are named preceding the qualifying

clause. For this reason the court below holds that the qualifying phrase in the 1918 Act does not apply to building and loan associations. The contrary, however, was decided by the Circuit Court of Appeals for the 6th Circuit in *Lilley Building & Loan Company* v. *Miller*, 285 Fed. 1020 (certiorari denied, 262 U. S. 754), adopting the opinion of the District Court reported in 280 Fed. 143. It is to be observed that the Court of Claims gives an unlimited exemption to societies which call themselves building and loan associations merely because the statute omits a comma. It is submitted that this is directly in conflict with the rule laid down by this Court time and again that exemptions from taxation are to be strictly construed in favor of the Government, and ignores the principle that the words of the statute extend no further than its purpose, since such holding is not in accord with the purpose of Congress in creating exemptions.

It is true that in the Revenue Act of 1921 (Section 231 (4), c. 136, 42 Stat. 227, 253), Congress has changed the language used in the Act of 1918, but it is submitted that this change did not eliminate the necessity for that mutuality which is the fundamental characteristic of building and loan associations. In one aspect the change broadened the exemption granted by permitting the regular acquisition of funds from sources other than members if substantially all of these funds were loaned to members. In another aspect the change restricted the

exemption by eliminating those associations which did not confine their loans to members, although the reason for departing from this practice was the lack of membership applications.

The respondent in this case is not a building and loan association within this common and ordinary meaning of that term, and, therefore, is not within the spirit of the Act. Certainly the fact that it has availed itself of the right given to it by the laws of Ohio to call itself a building and loan association, and the fact that, within the laws of that State, it is treated as though it were a building and loan association do not affect the construction of the Federal Act, and do not preclude this Court from restricting the exemption to those associations which are not only in name but in fact building and loan associations. *Burk-Waggoner Oil Association* v. *Hopkins*, 269 U. S. 110. On the other hand, the incidental activities of a building and loan association, carried on to enable it to accomplish its primary purposes, would not debar it from exemption. Article 515, Regulations 45, T. D. 3179.

> *Pacific Building and Loan Association* v. *Hartson*, 201 Fed. 1011;
>
> *Parkview Building & Loan Ass'n* v. *Herold*, 203 Fed. 876;
>
> *Central Building, Loan & Savings Co.* v. *Bowland*, 216 Fed. 526.

But the respondent has not departed merely incidentally from the conduct of a building and loan association. It has departed fundamentally from

the principles and purposes of such an association and has conducted its business primarily along other lines. It is operated for the benefit of stockholders rather than members. Compare *Appeal of Johnstown Building & Loan Association*, 6 B. T. A. 463, and *Broadview Savings & Loan Co.* v. *Commissioner*, 10 B. T. A. 725.

Respondent has advanced a large part of its funds to others than members. The findings made by the court below (Finding VIII, R. 10) show that, considered from the standpoint of the total amount of loans for each year, in the year 1918 it loaned 24.64% to members and 75.36% to nonmembers. In 1919 it loaned 61.51% to members and 38.49% to nonmembers. In 1920 it advanced 44.55% to members and 55.45% to nonmembers. In 1921 it advanced 55.47% to members and 44.53% to nonmembers. In 1922 it advanced 64.90% to members and 35.10% to nonmembers. In 1923 it advanced 98.30% to members and 1.70% to nonmembers. It should be pointed out, however, that, as to the later years, and especially as to the year 1923, this figure is misleading, for the reason that during said year respondent considered as members persons who took loans and then subscribed to a nominal number of shares of stock, such as one or five shares; their stock subscriptions having no relation whatsoever to the amount of their loans.

As heretofore shown in the Statement of Facts, if we consider Finding VIII (R. 10) from the standpoint of the number of loans we find the percent-

ages of such loans to nonmembers during each year to be:

	Per cent		Per cent
1918	57.3	1921	23.9
1919	35	1922	20
1920	40.1	1923	9.6

And again, as to this statement it should be pointed out that the figures for the later years, and especially 1923, are misleading because of the nominal stock subscriptions permitted during said years, such stock subscriptions having no relation to the amount of the loans. It was also heretofore pointed out in the Statement of Facts that, if we consider this question from the standpoint of the aggregate of the deposits in other building and loan associations and financial institutions and the loans to nonmembers, we find that the percentage of such business with nonmembers for the respective years involved is as follows:

	Per cent		Per cent
1918	85.94	1921	50.47
1919	58.04	1922	50.88
1920	63.68	1923	25.36

These figures for the later years, and especially 1923, are also misleading in that persons having nominal stock subscriptions are considered as members in such figures.

The funds thus loaned were derived, in a substantial part at least (Item 6 of Liabilities, Finding VII, R 9), by accepting time deposits from persons who were not members of the association.

Heretofore in the Statement of Facts it has been shown that such deposits for the respective years

constituted the following percentages of the total liabilities of said company:

	Per cent		Per cent
1918	53.3	1921	60.8
1919	59.3	1922	61
1920	60.2	1923	62.8

and that during such period the deposits greatly exceeded the receipts from stock subscriptions and also greatly exceeded the amount loaned to members. The Statement of Facts with appropriate references to the record also shows that during the years involved the loans increased by about $806,000; the special deposits increased over $630,000; the paid up stock increased over $135,000; while the loan and running stock decreased over $62,900. These facts show conclusively that the deposits were far in excess of the requirements of borrowing members and were accepted, not for the purpose of accomodating such members, but solely for the purpose of making money. The record shows that a large part of the profits which the members received were made by dealings with others than members and that the business must have been conducted primarily for pecuniary gain and not for mutual benefit. Should we add to this the fact requested in the Government's motion to remand, which the Court of Claims failed to find and which was the subject of an agreed statement of facts before the Court of Claims, that the dividends on running stock steadily decreased from 1918 to 1923, with the exception of one year (1921), while the dividends on paid up stock steadily in-

creased (the dividends in 1918 on paid up stock amounted to $2,521.72 and in 1923 to $12,089.09), the Government's contention that this company had ceased to be a building and loan association in the true sense of the word is further fortified. Such paid up stock has been said to be contrary to the genius and purpose of a building and loan association.

> *Rhodes* v. *Missouri Savings & Loan Company*, 173 Ill. 621.
>
> *Eversmann* v. *Schmitt*, *supra*.
>
> *Leahy* v. *National Building & Loan Ass'n.*, 100 Wis. 555.

The Court of Claims states in its opinion (R. 14–15) that the deposit of surplus funds with other building and loan associations and the acceptance of deposits and the making of loans to nonmembers resulted in "benefits" which accrued to members only and that there was no objection "to this occasional practice," since the borrowing needs of the members were always taken care of. This statement not only overlooks the fact that the practice was not occasional, but was the customary course of conducting the business, but also overlooks the inherent nature of a building and loan association. Such an association is not organized to make money for its members. The excuse for its being is that a certain end may be obtained, and that end is by cooperation to accumulate a fund to be loaned to members, for the purpose of building or acquiring homes.

The Court of Claims found that the net profits were distributed by way of dividends to members

only. (R. 8.) The court considered all of the stockholders to constitute the membership of the association. Generally this is true, but in the case at bar it leads to confusion because it is indicated by the opinion of the Court of Claims (R. 16), and, as heretofore pointed out, it is conclusively shown by the findings requested but refused, and which findings are made in part the subject of a motion in this Court to remand, that the borrowing members were not limited to loans equalling their subscriptions. This situation also renders Finding VIII (R. 10) misleading in its classifications of loans to members and nonmembers, especially as to the latter years involved.

A loan in excess of the stock subscription is not, as to that excess, a loan to a member in the ordinary sense, because the profits of the association do not operate to reduce it. "One of the main justifications for building associations is the fact that the earnings are social assets, to be divided among the membership so that while a borrowing member is required to pay interest, premium and fines, a large portion being an equal share thereof is returned to him in the shape of dividends." *Gray* v. *Baltimore Building & Loan Ass'n.*, 48 W. Va. 164; *People* v. *Preston*, 140 N. Y. 549.

In administering the various tax laws providing an exemption for building and loan associations the practice of the Bureau of Internal Revenue has been neither consistent nor long continued. The regulations were changed from time to time (See

Appendix hereto, p. 21) to meet the rules laid down by the courts. But under none of them was the exemption allowed, as the Court of Claims in its opinion (R. 13) seems to suppose, to every organization calling itself a building and loan association. Under the regulations promulgated under the 1918 Act (Regulations 45, 1920 Ed., Art. 515, T. D. 3179, Appendix, p. 25) collections were made from associations conducting their business in the manner which the respondent conducts its business. These regulations were enforced prior to the passage of the Revenue Act of 1921, as is disclosed by the date of their promulgation.

The change of the language in the 1921 Act, as has been pointed out, broadened the exemption in that, under the 1921 Act, the operations of a building and loan association in regard to the securing of money were immaterial provided substantially all its loans were made to members. The respondent in this case might, therefore, come within the 1921 Act if it appeared that its loans were substantially all made to its members. The record heretofore discussed discloses this was not the fact. As has been previously pointed out, Finding VIII of the Court of Claims as to the amount of loans made to members and nonmembers is misleading.

Particularly is this true as regards the year 1923. The finding shows that 98.30% of the loans made in that year were made to members. This is because—

(*a*) It ignores loans made to other building and loan associations, and financial institutions and

mortgages purchased. Including these items in nonmember loans will show such loans to amount to 25% instead of 1.70%.

(*b*) It accredits to members the full amount of the loan although that amount is far in excess of the members' subscription to stock. The borrower was a nominal member only and was not a member in the sense of sharing in accordance with his weekly deposits. This it is submitted is not a compliance with the spirit of the Revenue Act of 1921. (But see *Acklin* v. *People's Savings Association*, 293 Fed. 392; Sol. Mem. 1469, III–1 C. B. 252; Sol. Mem. 2133, III–2 C. B. 218; Sol. Mem. 2116, III–2 C. B. 209.)

The motion to remand

A motion to remand to the Court of Claims for additional findings of fact and brief in support thereof has heretofore been filed in this case by the Government. While it is believed that, upon the facts already found by the Court of Claims, the decision by the Court of Claims is erroneous and should be reversed, it is further believed that the facts requested in the motion to remand strongly indicate that the respondent herein was not a building and loan association in fact, and continued merely to be such in name, and that it was entirely outside not only the spirit and intent but also the letter of the exemption from income taxes. The importance, materiality, and effect of the findings requested in the motion to remand are more

fully set out and discussed in such motion and brief in support thereof, to which the Court's attention at this time is respectfully called, without needless repetition thereof. The most important additional finding requested is that, in a colorable attempt to comply with the requirement of the Revenue Act of 1921 that the business should be confined to making loans to members, the respondent issued nominal amounts of stock to persons to whom loans were made.

CONCLUSION

For the reasons heretofore set forth it is respectfully submitted that the decision by the Court of Claims is in error and should be reversed. And, while it is believed that upon the facts already contained in the findings of the Court of Claims such reversal should be made, it is further submitted that if this Court can not reverse the decision upon the findings already made the motion to remand should be granted upon the additional findings requested, which, it is believed, make reversal of such decision imperative.

Respectfully submitted.

WILLIAM D. MITCHELL,
Solicitor General.

HERMAN J. GALLOWAY,
Assistant Attorney General.

T. H. LEWIS, JR.,
Attorney, Bureau of Internal Revenue.

SEPTEMBER, 1928.

APPENDIX

Regulations 33, Art. 87 (applicable to 1913 Act), provides:

> The act specifically enumerates and exempts from its provisions and requirements labor, agricultural, or horticultural organizations, mutual savings banks not having a capital stock represented by shares, fraternal beneficiary societies, orders, or associations operating under the lodge system, or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders, or associations, and dependents of such members, domestic building and loan associations, cemetery companies organized and operated exclusively for the mutual benefit of their members, any and all corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of whose net income inures to the benefit of any private stockholder or individual, business leagues, chambers of commerce, or boards of trade not organized for profit, no part of the net income of which inures to the benefit of the private stockholder or individual, and civic leagues or

similar organizations not organized for profit, but operated exclusively for the promotion of social welfare.

Domestic building and loan associations are among those enumerated as exempt from the requirements of the law. A domestic building and loan association is held to be one organized under and pursuant to the laws of the United States, or of a State or Territory thereof, or under the laws applicable to Alaska or the District of Columbia. Mutuality in operation and in the distribution of profits and benefits is essential to exemption. Therefore, in order to come within the exempted class such associations must not only be "Domestic," as defined, but they must be organized and operated exclusively for the mutual benefit of the members; that is, all the profits and benefits provided for in the articles of association and by-laws must be ratably distributed among all members regardless of the kind of stock held, according to the amount of money they have on deposit. An association issuing different classes of stock upon which different rates of interest or dividends are guaranteed or paid, does not come within the exempted class.

Regulations 33 (Revised), Art. 68, Paragraphs 313, 314, and 317 (applicable to 1916 and 1917 Acts), provides:

PAR. 313. *Unconditional.*—Among the corporations exempt from the tax, without condition, are labor, agricultural and horticultural organizations, mutual savings bank

not having capital stock represented by shares, fraternal beneficiary society, order, or association operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, domestic building and loan associations, Federal land banks, and national farm loan associations, organized pursuant to the Act of July 17, 1916, joint-stock land banks as to income specified in the law, and public utilities whose income inures to the benefit of any State, Territory, or political subdivision thereof.

PAR. 314. In all cases wherein the exemption is without condition, and the collector is satisfied that the organization comes within the exempted class, he will be authorized to eliminate it from his list and relieve it from the necessity of making returns.

PAR. 315. Corporations exempt under the Act of September 8, 1916, are also exempt from the war income tax imposed by Title I of the Act of October 3, 1917.

Art. 70 of said Regulations 33 (Revised) provides:

Domestic building and loan associations.—A domestic building and loan association entitled to exemption is one organized under and pursuant to the laws of the United States or under and pursuant to the laws of some State or Territory thereof, and which is actually carrying on for the benefit of its members a building and loan association business in accordance with the laws under

which it is organized. The fact that such an association issues fully paid or prepaid shares, calling for a specified rate of interest or dividends, will not disqualify it for exemption. The exemption is without qualification other than that the association is a domestic building and loan association. If a corporation by any other name is carrying on an exclusive building-and-loan business, before it is entitled to exemption it will be incumbent upon it to show to the satisfaction of the commissioner of internal revenue that it is in fact a building and loan association.

Art. 515, Regulations 45 (1920 ed.) (applicable to 1918 Act), provides:

Building and loan associations and cooperative banks.—In general, a building and loan association entitled to exemption is one organized pursuant to the laws of the United States or of some State or Territory thereof, which accumulates funds to be loaned to its members and to be repaid in small periodical installments, and in which the members of the association share in the profits on substantially the same footing. It does not prevent exemption that the association issues prepaid stock entitled to a specified percentage of the profits. Where a building and loan association has no other features which render it liable to income tax, it will ordinarily not be subject to tax merely because—

(1) It has paid-up shares which are (a) preferred as to earnings, and (b) have a definite rate of interest which may be higher

than the rate of dividends paid on other stock, or

(2) Its balance sheets show that it is lending considerable sums to nonmembers, or

(3) It is a regular borrower of large sums of money which it uses for loans to members, the dues paid by members being entirely inadequate for the business transacted by it.

Cooperative banks without capital stock organized and operating for mutual purposes and without profit are exempt. Credit unions, such as those organized under the laws of Massachusetts, being in substance and in fact the same as cooperative banks, are likewise exempt from tax.

Art. 515, Regulations 45 (1920 ed.), T. D. 3179, June 16, 1921 (applicable to 1918 Act), provides:

Building and loan associations and cooperative banks.—In general, a building and loan association entitled to exemption is one organized pursuant to the laws of the United States, or some State or Territory thereof, which accumulates funds for the primary business of making loans to its members for the purpose of building or acquiring homes, and in which the members of the association share in the profits on substantially the same footing. It is essential that the association should be (a) mutual; (b) organized and operated for the accumulation of funds to be loaned primarily to members for home building. Where a building and loan association has no other features which render it liable to income tax it will ordinarily not be subject to tax merely because—

(1) It has paid-up shares which are (a) preferred as to earnings and (b) have a definite rate of interest which may be higher than the rates of dividends paid on their stock.

(2) It borrows large sums of money (accepting deposits is considered as borrowing), which it uses primarily for loans to members, the dues paid by members being entirely inadequate for this purpose.

(3) In times of small demand it loans considerable sums to nonmembers from or invests association funds which would otherwise lie idle and unproductive.

(4) The amount of prepaid or full-paid stock is disproportionate to running or installment stock, provided the issuance of such prepaid or full-paid stock is incidental to the furtherance of the main business of the association; that is, that it is intended to provide a fund from which loans may be made primarily to persons subscribing to the running or installment stock to enable them to acquire or build homes.

Where, however, the facts show that a building and loan association is borrowing large sums of money from nonmembers with no reference to the borrowing needs of its members, and is in turn loaning these sums to nonmembers, the number of depositors being disproportionate to the number of members, and the amounts loaned to nonmembers being disproportionate to the amount loaned to members, such association will be deemed to be taxable and will be granted exemption

only upon a satisfactory showing to the Commissioner that it is, in fact, a bona fide building and loan association within the meaning of this article.

Cooperative banks without capital stock organized and operated for mutual purposes and without profit are exempt. Credit unions, such as those organized under the laws of Massachusetts, are in substance the same as cooperative banks, and when organized and operated without capital stock, for mutual purposes and without profit, are likewise exempt.

Art. 515, Regulations 62 (applicable to 1921 Act), provides:

Building and loan associations and cooperative banks.—In general, a building and loan association entitled to exemption is one organized pursuant to the laws of any State, Territory, or the District of Columbia, which accumulates funds to be loaned primarily to its shareholders for the purpose of building or acquiring homes. In order to be exempt the association (1) must be mutual, that is, all of its stockholders or members must share in the profits on substantially the same footing; and (2) must be operated so that substantially all of its business is confined to the making of loans to bona fide shareholders. A building and loan association otherwise exempt does not lose its exempt status because—

(1) It has paid-up shares which are (a) preferred as to earnings, and (b) have a defi-

nite rate of interest which may be higher than the rate of dividends paid on other stock.

(2) It borrows money (accepting deposits is held to be a form of borrowing) which it uses for loans to shareholders, the dues, fines, and penalties paid by shareholders being inadequate for this purpose.

(3) It makes loans to nonmembers from accumulated funds which are not needed for loans to shareholders. In any such case, however, the burden will be upon the association to show that substantially all of its loans are made to members.

(4) The amount of its prepaid or full-paid stock is disproportionate to running or installment stock, provided the issuance of such prepaid or full-paid stock is ancillary to the furtherance of the main business of the association; that is, that it is intended to provide a fund from which loans may be made primarily to persons subscribing to running or installment stock to enable them to acquire or build homes.

Cooperative banks without capital stock organized and operated for mutual purposes and without profit are exempt. Credit unions such as those organized under the laws of Massachusetts, being in substance and in fact the same as cooperative banks, are likewise exempt from tax.

See also Sec. 213 (b) (10), Revenue Act of 1921, exempting dividends and interest paid to members, and Art. 89, Regulations 62.

○